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IN THE

Supreme Court of the United States

CELLCO PARTNERSHIP
D/B/A VERIZON WIRELESS,

Petitioner,

v.

KEITH LITMAN, ET AL,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether the Federal Arbitration Act ("FAA") preempts generally applicable state contract law providing that a class action ban in an arbitration agreement can be unconscionable and unenforceable in certain circumstances.

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INTRODUCTION

The Court has already granted certiorari, and heard oral argument on November 9, 2010, in *AT&T Mobility LLC v. Concepcion* (No. 09-893), on the issue whether the FAA preempts generally applicable state contract law providing that a class action ban in an arbitration agreement can be unconscionable and unenforceable in certain circumstances.

Petitioner Cellco Partnership d/b/a Verizon Wireless acknowledges in its petition for a writ of certiorari that *Concepcion* and this case are substantially factually identical. Petition at 3, 11. Furthermore, because New Jersey law, and specifically the New Jersey Supreme Court decision in *Muhammad v. County Bank of Rehoboth Beach, Del.*, 189 N.J. 1 (N.J. 2006), are applicable here, many of the arguments in the petition – *i.e.*, that New Jersey purportedly "has a separate, different unconscionability standard for arbitration" (Petition at 6-8), and that New Jersey courts purportedly "distort [and manipulate] unconscionability law to disfavor arbitration agreements" (Petition at 22-30) – are merely attempts by Petitioner to adapt to New Jersey law the same arguments raised in *Concepcion* with respect to California law. Just as the Court should reject the invitation to second-guess California law in *Concepcion*, so too it should reject the invitation to second-guess New Jersey law here.

That this case is substantially factually identical to *Concepcion* and closely tracks the legal arguments raised there does not mean that the petition merits a separate grant of certiorari. Recognizing this, Petitioner alternatively requests that, "[a]t a minimum . . . the

Court should 'hold' this petition pending its decision in *Concepcion*." Petition at 3.

In an attempt to distinguish this case, however, Petitioner also raises an "additional theory" to support the grant of its petition "in its own right" – that FAA § 2 "preempts state law that does not relate to 'the making of the agreement to arbitrate,' including substantive unconscionability." Petition at 3-4, 5-6, 13, 14-22. According to Petitioner, "consideration of this additional theory of preemption is thus necessary for a full understanding of Section 2's preemptive sweep[, and a] grant of certiorari is warranted here to allow the Court to address FAA preemption in a comprehensive manner this Term." Petition at 4.

Respondents Keith Litman and Robert Wachtel will not revisit all of the merits-related arguments already thoroughly explored in *Concepcion*. Rather, Respondents focus principally on the misstatements of fact and of New Jersey law in the petition.

Specifically, Respondents will establish that the facts and New Jersey authority contradict Petitioner's contention that New Jersey is somehow engaging in "subterfuge" to disfavor arbitration. To the contrary, there has been no distortion or manipulation, but only the neutral application of long standing, well-established, generally applicable New Jersey contract law principles. Additionally, Respondents will establish that the Court's decisions, the legislative history of the FAA, and pertinent authorities contemporaneous with the passage of the FAA contradict Petitioner's "additional theory" that the FAA preempts the application by a state of "substantive

unconscionability" or public policy under generally applicable state contract law as a basis for determining that a class action ban in an arbitration agreement can be unconscionable and unenforceable in certain circumstances.

Thus, the petition should be denied.

STATEMENT

1. Respondents' Claims

Respondents assert claims against Petitioner for breach of contract and violations of New Jersey's Consumer Fraud Act, N.J.S.A. § 56:8-1, *et seq.*, based on Petitioner's imposition of an newly-minted, per-line "administrative charge" ("Administrative Charge") beginning in October 2005. Compl. ¶¶ 1-4 (Joint Appendix on Appeal, Vol. II, at A26-A28). When first implemented in October 2005, the Administrative Charge was $0.40 per line, and was imposed on approximately 50 million lines, generating new revenues for Petitioner of approximately $20,000,000 monthly. *Id.* In March 2007, the Administrative Charge was increased by 75%, to $0.70 per line, and was imposed on some 60 million lines, generating revenues of approximately $42,000,000 monthly and $500,000,000 annually. *Id.*

Respondents allege that the Administrative Charge is a discretionary, improper pass-through of Petitioner's general overhead costs wholly unrelated to specific lines, and was implemented by Petitioner to effect a concealed increase in the agreed-upon monthly rates for service. *Id.* The Customer Agreement included no reference to the

Administrative Charge from the time it was implemented in October 2005 until November 2006. The November 2006 Customer Agreement first expressly referencing the Administrative Charge stated that Petitioner's billed charges would "include Federal Universal Service, Regulatory and Administrative Charges, and may also include other charges related to our governmental costs" (Joint Appendix on Appeal, Vol. II, at A52). The Customer Information Overview accompanying Petitioner's November 2006 Customer Agreement described the Administrative Charge as a charge "to recover or help defray costs of taxes and of governmental surcharges and fees imposed on us, and costs associated with governmental regulations and mandates on our business." *Id.* at A50. The Administrative Charge purportedly recovered the same costs when it was implemented in October 2005 at $0.40 per line as when it was increased by 75%, to $0.70 per line some seventeen months later, in March 2007. Compl. ¶ 21(b) (Joint Appendix on Appeal, Vol. II, at A35).

Notwithstanding Petitioner's description of the Administrative Charge in the Customer Agreement and Customer Information Overview, Petitioner admitted on brief in the District Court proceedings that it was using the Administrative Charge to "recove[r] general costs it incurred to provide service," including "the costs of building new cell sites." District Court Docket, *Litman, et al v. Cellco P'shp d/b/a Verizon Wireless*, No. 07-CV-4886 (D.N.J.), Docket Entry # 9-2, at pp. 28-29.

By contrast, a federal district court judge analyzing the same uniform contract and disclosure documents provided to Petitioner's customers concluded, without qualification, that the Administrative Charge was

supposed to be a recovery of "governmental-surcharge-related costs." In *Smale v. Cellco P'shp d/b/a Verizon Wireless*, 547 F. Supp. 2d 1181, 1186 (W.D. Wash. 2008), U.S. District Judge Richard Jones held as follows regarding Petitioner's imposition of the Administrative Charge and other "governmental related charges:"

> The "Customer Information Overview" includes a statement that customers' bills "will include charges to recover or help defray costs of taxes and of governmental surcharges and fees imposed on us." The overview states that "[t]he charges include" the Federal Universal Service Charge, the Regulatory Charge, and the Administrative charge. This disclosure is perhaps more limiting than the Agreement itself, because it does not explicitly state that Verizon reserves the right to impose other charges in addition to the three charges disclosed. *Instead, it states that its governmental-surcharge-related costs will "include" those three categories.* Standing alone, this disclosure is at least arguably unclear as to the possibility of additional charges, because it does not state that such charges "include, but are not limited to," those three categories. But, reading this disclosure in conjunction with the Agreement, which explicitly discloses Verizon's right to assess other governmental-cost-related charges, there is no lack of clarity. (Emphasis added).

2. The Parties' Arbitration Agreement

The arbitration agreement between Petitioner and Respondents and all of Petitioner's other customers, effective in and after November 2006 and when the action was commenced in October 2007, provided in pertinent part as follows (Joint Appendix on Appeal, Vol. II, at A54-A55, A71-A72):

> WE EACH AGREE TO SETTLE DISPUTES . . . ONLY BY ARBITRATION.
>
> * * *
>
> (1) THE FEDERAL ARBITRATION ACT APPLIES TO THIS AGREEMENT. . . . ANY CONTROVERSY OR CLAIM ARISING OUT OF OR RELATING TO THIS AGREEMENT, OR ANY PRIOR AGREEMENT FOR WIRELESS SERVICE WITH US . . . WILL BE SETTLED BY [ARBITRATION].
>
> * * *
>
> (3) . . . THIS AGREEMENT DOESN'T PERMIT CLASS ARBITRATIONS EVEN IF TH[E] PROCEDURES [OF THE AMERICAN ARBITRATION ASSOCIATION OR BETTER BUSINESS BUREAU] WOULD.
>
> * * *
>
> (6) IF FOR SOME REASON THE PROHIBITION ON CLASS ARBITRATIONS

> SET FORTH IN SUBSECTION 3 ABOVE IS DEEMED UNENFORCEABLE, THEN THE AGREEMENT TO ARBITRATE WILL NOT APPLY. FURTHER, IF FOR ANY REASON A CLAIM PROCEEDS IN COURT RATHER THAN THROUGH ARBITRATION, WE EACH WAIVE ANY TRIAL BY JURY.

The Customer Agreement also includes the following choice-of-law provision (Joint Appendix on Appeal, Vol. II, at A55, A72):

> Except to the extent we've agreed otherwise in the provisions on late fees, collection costs and arbitration, or as required by Federal law, this agreement and disputes covered by it are governed by the laws of the state encompassing the area code assigned to your wireless phone number when you accepted this agreement, without regard to the conflicts of laws rules of that state.

Petitioner's principal offices are in New Jersey, and Respondents' wireless phone numbers both have New Jersey area codes. Compl. ¶¶ 7, 11 (Joint Appendix on Appeal, Vol. II, at A29, A30). Under the choice-of-law provision quoted immediately above, New Jersey law governs.

Thus, in the District Court, Petitioner conceded that *Muhammad* applies to its arbitration agreement with Respondents, although it contended that whether *Muhammad* "controls" depends solely on resolution of the FAA preemption issue (Joint Appendix on Appeal, Vol. II, at A78):

> Verizon does not challenge, for purposes of this [Petition], that the New Jersey Supreme Court's decision in *Muhammad* applies to Verizon's arbitration agreement. Moreover, Verizon is in agreement with Plaintiffs that, if *Muhammad* controls, Plaintiffs are entitled to proceed with this lawsuit. To resolve this dispute, this Court therefore must determine whether *Muhammad* is preempted under the FAA.[1]

3. The Decision Of The New Jersey Supreme Court In *Muhammad*

Muhammad involved claims for violations of New Jersey consumer fraud statutes based on allegedly illegal interest rates charged in connection with short-term, single advance, unsecured loans. 189 N.J. at 6, 7. In Muhammad's case, she obtained several loans over a short

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1. Although Respondents believe the petition should be denied, on October 22, 2010 Respondents also filed a conditional cross-petition for a writ of certiorari (No. 10-551) presenting the following question based on the express terms of the Customer Agreement as an alternative theory for ruling against Petitioner on the merits:

> Whether the Federal Arbitration Act ("FAA") requires the enforcement of a drafting party's express agreement not to arbitrate but to litigate in court if the class action ban in the arbitration agreement is unenforceable, where that party incorporates state law under its choice-of-law provision that contractual class action bans are unenforceable.

For the reasons stated in the conditional cross-petition, the Court should grant the conditional cross-petition for a writ of certiorari if it grants the petition.

period of time, and her second loan, for $200 on May 23, 2003, required the payment on June 13, 2003 of principal and a finance charge of $60 (a disclosed annual interest rate of more than 600%). *Id.* at 7. The loan documents included arbitration agreements with class action bans. *Id.* at 8-9.

The issue decided by the New Jersey Supreme Court in *Muhammad,* as stated in the first paragraph of the opinion, was "whether a provision in an arbitration agreement that is part of a consumer contract of adhesion is unconscionable and therefore unenforceable because it forbids class-wide arbitration." 189 N.J. at 6. At the outset, the Court stated its holding:

> Applying the controlling test for determining unconscionability for contracts of adhesion . . . , we hold that the class-arbitration waiver in this consumer contract is unenforceable. *Such a waiver would be unconscionable whether applied in a lawsuit or in arbitration. Id.* (Emphasis added).

For its analysis, the *Muhammad* Court begins with a clear statement of its understanding of the purposes of the FAA, and of the *Muhammad* Court's role under the FAA in deciding the unconscionability issue before it, 189 N.J. at 11-12:

> Congress enacted the FAA, 9 U.S.C.A. §§ 1-16, "to abrogate the then-existing common law rule disfavoring arbitration agreements 'and to place arbitration agreements upon the same footing as other contracts.'" *Martindale*

> *v. Sandvik, Inc.*, 173 N.J. 76, 84, 800 A.2d 872 (2002) (quoting *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24, 111 S. Ct. 1647, 1651[ ] (1991)). Section 2 of the FAA provides that arbitration agreements covered by the Act "shall be valid, irrevocable, and enforceable save upon grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C.A. § 2. "In enacting section 2 of the FAA, 'Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.'" *Martindale, supra*, 173 N.J. at 84, 800 A.2d 872 (quoting *Southland Corp. v. Keating*, 465 U.S. 1, 10, 104 S. Ct. 852, 858[ ] (1984)). The FAA, however, does not preclude an examination into whether the arbitration agreement at issue is unconscionable under state law. *Id.* at 85-86, 800 A.2d 872.
>
> "[G]enerally applicable contract defenses, such as fraud, duress, or *unconscionability*, may be applied to invalidate arbitration agreements without contravening § 2." *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687, 116 S. Ct. 1652, 1656 (1996) (emphasis added)[.]

Having articulated its understanding of the authorities supporting its right to evaluate the unconscionability of the class waiver before it under the FAA based on controlling decisions of this Court and the New Jersey Supreme Court, the *Muhammad* Court then proceeded to set forth the *general* doctrine of unconscionability concerning

contracts of adhesion under New Jersey state law – *all* contracts of adhesion generally, and not just adhesive arbitration agreements. 189 N.J. at 15-16. Under New Jersey law, contracts of adhesion "invariably evidence some characteristics of procedural unconscionability," but nevertheless are valid unless "deemed unenforceable based on policy considerations." This policy inquiry involves a "case-by-case" "multi-factor analysis," including a "careful fact-sensitive examination into substantive unconscionability" – generally defined as the existence of "harsh or unfair one-sided terms." *Id.* (citations omitted).

Finding the relevant arbitration agreement to be "clearly a contract of adhesion," the *Muhammad* Court proceeded to consider the four established factors outlined in *Rudbart v. North Jersey Dist. Water Supply Comm'n*, 127 N.J. 344, 356 (1992). While the first three *Rudbart* factors (the subject matter of the contract, the parties' relative bargaining position, and the degree of economic compulsion motivating the adhering party) enhanced the degree of procedural unconscionability present, these three factors alone were "insufficient to render the contract unenforceable." 189 N.J. at 18-19. Rather, the *Muhammad* Court determined that "adhesive consumer contracts, which are ordinarily enforceable, may rise to the level of unconscionability when substantive contractual terms and conditions impact 'public interests' adversely." 189 N.J. at 19.

Hence, the *Muhammad* Court's unconscionability analysis hinged upon the fourth *Rudbart* factor – and the only one presenting a true question of substantive unconscionability (*i.e.*, the nature and effect of the challenged terms): the "public interests affected by the

contract." In *Muhammad*, the application of this factor involved an assessment of whether the class arbitration waiver at issue essentially "preclude[d] any realistic challenge" to the terms of the plaintiff's underlying loan contract, thereby "shield[ing] defendants from compliance with the laws of this State." *Id.* Preliminarily, the Court noted the justifications for the class action vehicle and its long-recognized value "to litigants, to the courts, and to the public interest." 189 N.J. at 17. In particular, federal and state courts (including several New Jersey decisions) have widely recognized that class treatment of claims may often present the only genuine remedy to potential plaintiffs for the redress of alleged wrongs. In low value cases, especially in complex matters, consumers have little if any incentive to pursue individual actions and may find it difficult or impossible to secure legal representation. 189 N.J. at 16-18, 20-21 (quoting *Carnegie v. Household Finance Int'l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004) (Posner, J.) ("only a lunatic or fanatic sues for $30")).

Additionally, the *Muhammad* Court recognized that "without the availability of a class-action mechanism, many consumer-fraud victims may never realize that they may have been wronged." 189 N.J. at 20. Therefore, class waivers are "almost equivalent to closing the doors of justice to all small claimants." *Id.* By rendering the possibility of relief "illusory," class waivers "can act effectively as an exculpatory clause" – and thus may be "void as against public policy" under New Jersey law. 189 N.J. at 16, 19-20.

Accordingly, the *Muhammad* Court reiterated its main holding, 189 N.J. at 22:

> *As a matter of generally applicable state contract law*, it was unconscionable for defendants to deprive Muhammad of the mechanism of a class-wide action, *whether in arbitration or in court litigation*." (Emphasis added).

Additionally, the *Muhammad* Court again stressed that whether a class waiver is unconscionable depends on a "fact-sensitive analysis" including "the amount of damages being pursued" and the complexity of the factual and legal issues involved in the claim. 189 N.J. at 22 n.5.

Importantly, the *Muhammad* Court expressly noted that its holding could further "New Jersey's public policy favoring arbitration," because "contracting parties and the various arbitration forums can fashion procedural rules specific to class arbitration . . . and allow for the development of innovative class-arbitration procedures." 189 N.J. at 23-24.

Conversely, the *Muhammad* Court rejected any purported justification for the enforceability of class arbitration waivers based on potential efficiencies resulting from "the likelihood that fewer individual consumers would seek redress than those who would be included as part of a class"; according to the Court, "[t]he purpose of arbitration . . . is *not* to discourage consumers from seeking vindication of their rights." 189 N.J. at 23.

Finally, the *Muhammad* Court reached the issue of the appropriate remedy. Because, as a matter of state law, the invalid class waiver was severable from the arbitration clause as a whole, and because there was

nothing rendering the entire arbitration agreement void, the *Muhammad* Court determined that the remainder of the arbitration agreement was enforceable, and remanded for entry of an order compelling arbitration. *See* 189 N.J. at 26-27.[2]

REASONS FOR DENYING THE PETITION

The petition should be denied for two reasons. First, the applicable facts and New Jersey authority refute Petitioner's contention that New Jersey is somehow engaging in "subterfuge" to disfavor arbitration; to the contrary, there has been no distortion and manipulation, but only the neutral application of long standing, well-established, generally applicable New Jersey contract law principles. Second, the Court's decisions, the legislative history of the FAA, and pertinent authorities contemporaneous with the passage of the FAA contradict and refute Petitioner's "additional theory" that the FAA preempts the application by a state of "substantive unconscionability" or public policy under generally applicable state contract law as a basis for determining that a class action ban in an arbitration agreement can be unconscionable and unenforceable in certain circumstances.

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2. In a companion case decided the same day, the New Jersey Supreme Court applied the same unconscionability test to determine that a class action ban was *not unconscionable* in a case involving a high value claim; the Court required the companion case to be arbitrated as well. *See Delta Funding Corp. v. Harris*, 189 N.J. 28, 46-47 (N.J. 2006).

I. New Jersey Has Neutrally Applied Generally Applicable Contract Law Principles In Determining That Class Action Bans In Arbitration Agreements Can Be Unconscionable And Unenforceable In Certain Circumstances, And Has Not Engaged In Distortion Or Manipulation To Disfavor Arbitration

Acceptance of Petitioner's "distortion and manipulation" contention (Petition at 6-8, 22-30) would necessarily require this and the lower federal courts to second guess the New Jersey Supreme Court in order to conclude that the New Jersey Supreme Court had engaged in some sort of "subterfuge" to circumvent the strictures of the FAA. The "generally applicable state contract law" savings clause of FAA § 2, and the unmanageability of attempting to define a standard for the identification of this purported "subterfuge," strongly counsel against any such examination as a matter of federal law.

Of equal importance here, as a matter of substantive state contract law, Petitioner lacks any bona fide basis for its contention that the New Jersey Supreme Court engaged in "distortion and manipulation" in order to disfavor arbitration agreements.

A. *Muhammad* Is Expressly Neutral to Arbitration Agreements

The *Muhammad* Court was quite clear about the generally applicable nature of its holding regarding class action bans, twice:

> Applying the controlling test for determining unconscionability for contracts of adhesion

> . . . , we hold that the class-arbitration waiver in this consumer contract is unenforceable. *Such a waiver would be unconscionable whether applied in a lawsuit or in arbitration.* 189 N.J. at 6. (Emphasis added).
>
> *As a matter of generally applicable state contract law*, it was unconscionable for defendants to deprive Muhammad of the mechanism of a class-wide action, *whether in arbitration or in court litigation.*" 189 N.J. at 22. (Emphasis added).

Thus, on its face, *Muhammad's* holding is one of neutrality and "equal footing," not hostility to arbitration. *See, e.g., Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687, 688 (1996) (FAA preempts state law that "places arbitration agreements in a class apart from 'any contract,' and singularly limits their validity"); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 270-271, 281 (1995) (state's policy may not "place arbitration clauses on an unequal 'footing,' directly contrary to the Act's language and Congress' intent"). *See also Muhammad*, 189 N.J. at 11-12.

Conversely, to elevate arbitration agreements over non-arbitration agreements, as Petitioner is attempting to do, would conflict with the Court's decisions confirming that under the FAA, arbitration agreements are made "as enforceable as other contracts *but not more so.*" *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967) (emphasis added). *See also Volt Info. Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 478 (1989) (quoting *Prima Paint*).

B. The New Jersey Supreme Court Applied the Same Unconscionability Analysis to Class Action Bans on the Same Day in *Muhammad* and *Delta Funding*, Found the *Muhammad* Ban Unconscionable and the *Delta Funding* Ban Not Unconscionable, and Directed Both Cases to Arbitration

As Respondents observe in Note 2, *supra*, in *Delta Funding*, the companion case issued the same day as *Muhammad*, the New Jersey Supreme Court applied the same unconscionability analysis to different facts in connection with a class action ban in an arbitration agreement – a claim for $100,000 or more damages as compared to the damages of $600 in *Muhammad* – and held that the class action ban in the case of the high value claim was not unconscionable. *See Delta Funding*, 189 N.J. at 46-47. As in *Muhammad*, the New Jersey Supreme Court required that case to be arbitrated as well. *Id.* at 35.

Furthermore, far from disfavoring arbitration, the *Muhammad* Court expressly noted that its holding could further "New Jersey's public policy favoring arbitration," because "contracting parties and the various arbitration forums can fashion procedural rules specific to class arbitration . . . and allow for the development of innovative class-arbitration procedures." 189 N.J. at 23-24. While Petitioner notes that "the FAA was copied" from the existing New York arbitration act (Petition at 20 n.2, quoting *Allied-Bruce*, 513 U.S. at 287), the legislative history of the FAA confirms that it *also* was modeled after the New Jersey arbitration act in place before its enactment. *See* Arbitration of Interstate Commercial Disputes, Hearings on H.R. 646 and S. 1005 before the

Joint Committee of Subcommittees on the Judiciary, 68th Cong., 1st Sess. 40 (1924) ("*Joint Hearings*") ("The proposed Federal statute follows the form of the successful New York and New Jersey statutes with only such changes as seem necessary for the Federal statute.").

Only the most severe form of cognitive dissonance (to put it mildly) could begin to attempt to explain how the New Jersey Supreme Court -- applying the same test to class action bans on the same day and reaching opposite conclusions *and* requiring both cases to be arbitrated, all in furtherance of its long-standing public policy predating the enactment of the FAA of encouraging arbitration -- could somehow be "distorting and manipulating" its law to "disfavor" arbitration.

Petitioner, in fact, cites *Delta Funding* only twice in its petition: (i) first, in passing regarding the use by the New Jersey courts of a "sliding scale" approach considering the relative levels of both procedural and substantive unconscionability, Petition at 7; and (ii) second, for the proposition that the New Jersey Supreme Court "[held] that a class-arbitration waiver in any consumer contract in a case involving a 'low-value' dispute is substantively unconscionable," Petition at 29. The second citation by Petitioner is particularly remarkable, as the holding of *Delta Funding* is precisely the opposite – that a class action ban in a case involving a "high-value" dispute is *not* unconscionable.

C. Well-Established, Generally Applicable Principles of New Jersey Contract Law Regarding Unconscionable and Exculpatory Contract Provisions Expressly Include Considerations of Public Policy and the Impact on Third Parties

In an attempt to bolster its contention that the New Jersey courts distort or manipulate unconscionability law to disfavor arbitration agreements, Petitioner suggests that "[at] its base, substantive unconscionability examines only the contract terms as they relate to the individual parties at the time of contracting." Petition at 26. Similarly, Petitioner criticizes *Muhammad* because in connection with the New Jersey Supreme Court's discussion of the "alleged exculpatory nature of the class-action waiver," it "focused on the effect of the class action waiver on *third parties* and general corporate fraud enforcement as opposed to the rights and duties of the parties to the particular contract." Petition at 28. Petitioner's gripe, at best, is its disagreement with generally applicable New Jersey contract law regarding unconscionability and exculpatory contracts in place long before the issue of class action bans in arbitration agreements ever arose, and is factually and legally insufficient to support its assertion of "distortion and manipulation."

As noted in Statement (3), *supra*, the New Jersey Supreme Court in *Muhammad* reached its unconscionability holding by applying the four factors in connection with adhesion contracts articulated in the 1992 New Jersey Supreme Court decision in *Rudbart v. North Jersey Dist. Water Supply Comm'n*, 127 N.J. at 356. *Rudbart* involved a dispute between holders of new

project notes issued by the water supply commission and the underwriter/indenture trustee (*id.* at 349-50), and not an arbitration agreement. Citing to a long list of cases involving objectionable contract terms that had been analyzed based on their impact on the public interest and third parties in many other commercial settings -- but not arbitration agreements – the *Rudbart* Court stated:

> [I]n determining whether to enforce the terms of a contract of adhesion, courts have looked not only to the take-it-or-leave-it nature or the standardized form of the document but also to the subject matter of the contract, the parties' relative bargaining positions, the degree of economic compulsion motivating the "adhering" party, and the public interests affected by the contract. *Id.* at 356.

Another decision of the New Jersey Supreme Court cited by Petitioner in support of its contention of "distortion and manipulation," *Stelluti v. Casapenn Enterprises, LLC*, 203 N.J. 286 (N.J. 2010) (Petition at 7, 25, 27, 29), sets out comparable standards involving considerations of the public interest and the impact on third parties in the context of exculpatory contracts, stating that an exculpatory contract:

> is enforceable only if: (1) it does not adversely affect the public interest; (2) the exculpated party is not under a legal duty to perform; (3) it does not involve a public utility or common carrier; or (4) the contract does not grow out of unequal bargaining power or is otherwise unconscionable.

203 N.J. at 298, *quoting Gershon v. Regency Diving Center, Inc.*, 368 N.J. Super. 237, 248 (N.J. App. Div. 2004). *Stelluti* continued, 203 N.J. at 302:

> To the extent that any contract of adhesion also would require review to determine whether its enforcement implicates a matter of public interest, *see ibid.*, that test overlaps, and is subsumed by the more precise analysis employed when assessing whether to enforce an exculpatory agreement.

These *generally applicable contract principles* set out by the New Jersey Supreme Court cannot be reconciled with Petitioner's characterization of the law of unconscionability outside of the arbitration context. For example, according to Petitioner (Petition at 24, *see also* Petition at 6):

> There are two required elements of unconscionability in New Jersey: procedural unconscionability, which examines "the formation of the contract," and substantive unconscionability, which looks for "excessively disproportionate terms" or "the exchange of obligations so one-sided as to shock the court's conscience."

Petitioner's source for this seemingly absolute statement of the New Jersey law of contract unconscionability that the *Muhammad* Court supposedly is manipulating is the single opinion of a New Jersey Superior Court (*i.e.*, a trial level court) in *Sitogum Holdings, Inc. v. Ropes*, 352 N.J. Super. 555 (N.J. Super. Ct. 2002). Not that the *Sitogum*

court was wrong in finding procedural and substantive unconscionability, but nowhere does the decision cite to or reference the New Jersey Supreme Court's 1992 statement in *Rudbart* of the standards to be considered under generally applicable contract law in connection with an unconscionability determination. Furthermore, nowhere in *Rudbart* does the New Jersey Supreme Court reference or even use the term "shock the conscience" as the standard for substantive unconscionability. And, perhaps most tellingly, nowhere in its petition does Petitioner cite to or reference the New Jersey Supreme Court's decision in *Rudbart*, *i.e.*, the controlling statement of the law in New Jersey.

Petitioner's characterization of *Stelluti* as the seemingly absolute statement of New Jersey law outside of the arbitration context (Petition at 7, 25, 27, 29) is equally devoid of context. Aside from setting out the generally applicable contract principles quoted, *supra* (but ignored by Petitioner in its petition), *Stelluti* presents only a single application of those principles to an exculpatory clause in a health club membership. Insofar as the New Jersey Supreme Court held that the exculpatory provision there was enforceable, it was based on the consideration of the public interest of New Jersey as it relates to health clubs, sports and sport activities. The outcome in *Stelluti* is the result a contextual, case-by-case analysis of the pertinent New Jersey public policies, and is *not* in and of itself a statement of controlling state contract law principles, as Petitioner improperly tries to use it to evidence "distortion and manipulation."

D. The Conclusion of the New Jersey Supreme Court that the Class Action Ban Can Be Unlawfully Exculpatory Is Not Just an "Assumption" But a Mathematical Certainty under the Facts of This Case

According to Petitioner, "New Jersey courts will invalidate consumer arbitration agreements when the disputes involve low-dollar amounts, on the *assumption* that requiring bilateral arbitration will operate as an unlawful 'exculpatory clause.'" Petition at 7-8 (citing *Muhammad*, 189 N.J. at 19-20) (emphasis added). Later in the petition, Petitioner states that "the *Muhammad* court focused on the *allegedly* exculpatory nature of the class-action waiver." Petition at 28 (emphasis added).

In this case, there is nothing "assumed" or "alleged" about it. Giving Petitioner the benefit of the doubt – *i.e.*, that it genuinely intends to comply with its obligation to arbitrate individually with, and believes in the benefit of bilateral arbitration for, its customers in connection with claims like Respondents' here -- then assuming *arguendo* that Petitioner's 60 million customers in 2007 (when the challenged Administrative Charge was increased to $0.70) comprise 20,000,000 individual arbitration agreements, a one hour arbitration for each of these customers, 24 hours a day and 365 days a year, would take 2,283 years to resolve. At a more vigorous rate of 10 arbitrations per hour, arbitration of the claims could be completed in a mere 228 years – *i.e.*, sometime around 2240. Without regard to the arbitration filing fees of $2,000,000,000 at a conservative $100 apiece. For a claim of less than $10 a year per line. Only "a lunatic or a fanatic" would knowingly obligate itself to perform such an absurd contract.

Absurd or not, the numbers also assume that Petitioner's customers will actually discover Petitioner's unlawful and deceptive practices. As the New Jersey Supreme Court perceptively observed in *Muhammad*, however, "without the availability of a class-action mechanism, many consumer-fraud victims may never realize that they may have been wronged." 189 N.J. at 20. This case graphically illustrates that point as well. Assuming *arguendo* that Judge Jones -- the judge in *Smale* in the Western District of Washington (*see* Introduction (1), *supra*) -- was a Verizon customer, he never would be in a position to seek to arbitrate his claim, unaware that Petitioner's practices regarding the Administrative Charge are wrongful and deceptive because Petitioner is not using the Administrative Charge to recover governmental charges but rather as a concealed rate increase.

A contract provision that is impossible to perform or be performed is "illusory" and thus "exculpatory," as the *Muhammad* Court properly held. 189 N.J. at 16, 19-20.

II. Petitioner's "Additional Theory," That FAA § 2 Preempts State Law That Does Not Relate To "The Making Of The Agreement To Arbitrate," Including Substantive Unconscionability, Is Contradicted By This Court's Decisions, The Legislative History Of The FAA, And Pertinent Authorities Contemporaneous With The FAA's Enactment

Petitioner's "additional theory" for finding New Jersey law under *Muhammad* preempted is based on a heretofore undetected limitation. According to Petitioner, Congress purportedly intended in connection with passage of the

FAA to limit the generally applicable state contract law encompassed within the savings clause of FAA § 2 solely to defects in the formation of a contract, which Petitioner equates with "procedural unconscionability." Thus, the use of "substantive unconscionability" and consideration of public policy are preempted. Petition at 14-22.

Specifically, Petitioner's logic is as follows: Under FAA § 2, arbitration agreements are "valid, irrevocable and enforceable" as a matter of federal law, "save upon such grounds as exist at law or equity for the revocation of any contract." The declaration of "validity, irrevocability and enforceability" under federal law was intended to preclude courts from refusing to enforce otherwise valid arbitration agreements. Petition at 15. *See also Vaden v. DiscoverBank,* 129 S. Ct. 1262, 1274 (2009) ("courts traditionally viewed arbitration clauses as unworthy attempts to 'oust' them of jurisdiction" and "refused to order specific enforcement of agreements to arbitrate"). The use of the term "revocation" in the savings clause was intended by Congress to eliminate the ability of a contracting party to repudiate an arbitration agreement at will, but at the same time to preserve the "distinct" meaning of the term "revocability" as it was understood outside the arbitration context – purportedly, according to Petitioner based on its interpretation of certain selected authorities, "the more limited ability of a party to nullify a contract based on formation defects." Petition at 18-21. The purported focus of § 2's savings clause solely on "formation defects" is purportedly further supported by FAA § 4 which, according to Petitioner, provides that "[t]he only condition" that must be present for a court to compel arbitration is that the court be "satisfied that the *making of the agreement* for arbitration . . . is not an issue." Petition at 16 (emphasis in original).

The "additional theory" Petitioner has divined is flatly inconsistent with the decisions of the Court, the legislative history of the FAA, and pertinent authorities contemporaneous with the FAA's enactment.

A. The Court's Decisions Contradict Petitioner's "Additional Theory"

Not only has the Court never detected the extremely fine (indeed, almost invisible) distinction in the meaning of "revocation" pressed by Petitioner as the true understanding of Congress in enacting the FAA, but adoption of Petitioner's "additional theory" would require the wholesale overruling of all of the Court's FAA jurisprudence regarding the applicability of unconscionability and other generally applicable state contract law as a defense to the enforcement of an arbitration agreement under FAA § 2.

On a last-in-first-out basis, the list would begin with last term's decision in *Rent-A-Center, West, Inc. v. Jackson*, 130 S. Ct. 2772 (2010), in which the Court held that the substantive unconscionability challenges raised by the petitioner in connection with the arbitration agreement were required to be decided by the arbitrator under Nevada law, as stated by the terms of that specific agreement. *Id.* at 278-81. None of the three specific substantive unconscionability challenges raised in *Rent-A-Center* – unfairness with respect in the claims to be arbitrated rather than litigated, the sharing of arbitration costs and limitations on discovery – implicated procedural unconscionability. *Id.* Indeed, the Court declined to address the petitioner's "adhesion" procedural unconscionability challenge because none of

the three substantive unconscionability challenges went to the provision delegating all arbitrability issues to the arbitrator. *Id.* And while it is true that four Justices dissented vigorously from the majority's conclusion, no Justice on either side questioned that the substantive unconscionability challenges were proper subjects for decision by the appropriate decision-maker.

Similarly, Petitioner's "only revocation/procedural unconscionability" theory also would require overruling the Court's first decision articulating the propriety of unconscionability challenges under FAA § 2, *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987):

> We note, however, the choice-of-law issue that arises when defenses such as Thomas' so-called "standing" and unconscionability arguments are asserted. In instances such as these, the text of § 2 provides the touchstone for choosing between state-law principles and the principles of federal common law envisioned by the passage of that statute: An agreement to arbitrate is valid, irrevocable, and enforceable, *as a matter of federal law*, . . . "save upon such grounds as exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2 (emphasis in original). Thus *state law, whether of legislative or judicial origin, is applicable if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.* (Emphasis added).

In *Perry*, the particular unconscionability challenge was a *substantive* unconscionability challenge regarding the

fairness of the way the arbitration proceeding was to be conducted on the New York Stock Exchange – including the same type of discovery limitations involved in *Rent-A-Center*. *Id.* at 487 n.4.

Petitioner's theory also would require the Court to overrule the Court's decisions issued between *Rent-A-Center* and *Perry*, including *Doctor's Assocs.*, 517 U.S. at 686-687:

> Repeating our observation in *Perry*, the text of § 2 declares that state law may be applied "*if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." 482 U.S., at 492, n. 9, 107 S. Ct., at 2527, n.9. Thus, generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2.

As Justice Stevens observed in *Southland Corp. v. Keating*, 465 U.S. 1, 20 (1984) (concurring in part and dissenting in part): "A contract which is deemed void [as a matter of public policy] is surely revocable at law or in equity."

Petitioner's "additional theory" is untenable in light of the Court's unbroken linkage of invalidity, unenforceability and revocability -- including substantive unconscionability -- under § 2.[3]

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3. For the record, Petitioner's attempt to import consistency between "revocation" under § 2 and the condition that that "the (Cont'd)

B. The Legislative History of the FAA Contradicts Petitioner's "Additional Theory"

Petitioner's "additional theory" that Congress intended under FAA § 2 to preclude consideration of state law substantive unconscionability and public policy also is contradicted by the legislative history of the FAA.

Although Petitioner cites to page 38 of the *Joint Hearings* for general background regarding the enactment of the FAA (Petition at 20-21), the pages immediately before and after expressly discuss the propriety of the consideration of substantive law and public policy:

> A Federal statute providing for the enforcement of arbitration agreements does relate solely to procedure of the Federal courts. It is no infringement upon the right of each State to decide for itself what contracts shall and shall not exist under its laws. *To be sure whether or not a contract exists is a question of the substantive law of the jurisdiction wherein the contract was made. Joint Hearings* at 37. (Emphasis added).

(Cont'd)

making of the agreement for arbitration . . . is not an issue" under § 4 depends on the fact that Petitioner has excised the other half of the quoted provision from § 4 which is inconsistent with its argument. The entire provision in § 4 referenced by Petitioner states: "[the court] being satisfied that the making of the agreement for arbitration *or the failure to comply therewith* is not an issue" (emphasis added). The emphasized language obviously implicates issues of "validity" and "enforceability" under state law, as unconscionability defenses are precisely what get asserted when compliance is sought to be avoided.

* * *

> A promise that differences will be arbitrated is not illegal and a nullity without reference to the law in force when differences arise. Since it is directed solely to the remedy, *its validity is to be measured by the public policy prevailing when a remedy is sought.* In that respect, it is not different from a promise that future controversies shall be submitted to a court. The jurisdiction of the court at the time of the submission will determine whether the promise is to be rejected or enforced. This is so whether jurisdiction in the interval has been diminished or enlarged. *Of course, we exclude cases where the contract is inherently immoral or in contravention of a statute.* *Joint Hearings* at 39 (emphasis added), *quoting Berkovitz v. Arbib & Houlberg*, 230 N.Y. 261, 271-72 (N.Y. 1921) (Cardozo, J.) (holding that New York arbitration act applied to arbitration agreements entered into before enactment and required enforceability of agreement).

Thus, insofar as relevant and appropriately considered, the legislative history of the FAA contradicts Petitioner's alternative theory.

C. Pertinent Authorities Contemporaneous with the FAA's Enactment Contradict Petitioner's "Additional Theory"

Finally, in addition to the legislative history, including Justice Cardozo's opinion in *Berkovitz* cited therein,

even the authorities contemporaneous with the FAA's enactment cited by Petitioner contradict its additional theory.

In *Zimmerman v. Cohen*, 236 N.Y. 15, 19-20 (N.Y. 1923) (cited Petition at 19), the New York Court of Appeals held that the right to require arbitration under an arbitration agreement could be waived by litigating the dispute rather than arbitrating – *i.e.*, based on conduct occurring *after*, and not pertinent to, formation – and that a party to the agreement could not thereafter demand its enforcement at the time of trial.

Similarly, Petitioner cites to a passage from the work of Wesley A. Sturges, *A Treatise on Commercial Arbitrations and Awards* (1930) (Petition at 18-19). But on its face, the cited passage specifically states that an arbitration agreement can be "disregarded" when "induced by fraud, *or overreaching*, or entered into unadvisedly through ignorance, folly or undue pressure." (Emphasis added). The entire passage quoted by Sturges is from *Del. & H. Canal Co. v. Pa. Coal Co.*, 50 N.Y. 250, 258 (1872), and states:

> An agreement of this character [an arbitration agreement] induced by fraud, or overreaching, or entered into unadvisedly through ignorance, folly or undue pressure, might well be refused a specific performance, or disregarded when set up as a defence to an action.

As compared to the quoted reference to "undue pressure" which can be equated with procedural unconscionability, "overreaching" is a doctrine of

ancient origins and readily equates with "substantive unconscionability," as the New Jersey decision in *Sitogum* heavily relied on by Petitioner confirms:

> Roman law recognized the doctrine of "laesio ultra dimidum vel enormis" which permitted rescission [*i.e.*, revocation] upon a disproportionate exchange of promises. The doctrine is defined in *Black's Law Dictionary* (7th ed., 1999) as "the injury sustained by one party to an onerous contract when the overreaching party receives twice the value of the party's money or property, such as a purchaser who pays less than half of the value of the property sold, or a seller who receives more than double the property's value." 352 N.J. Super. at 560 n.7.

As for the isolated federal circuit court decisions from the latter part of the 20th century also cited by Petitioner (Petition at 16-17), they could hardly be relevant to the intent of Congress more than fifty years before, and none of them actually considers or even refers to unconscionability or the propriety of considerations of substantive unconscionability under § 2, or any of the Court's decisions on that subject.

CONCLUSION

For the foregoing reasons, the Court should deny the petition for a writ of certiorari.

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